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July 6, 1994

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JUL 6 1994

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

**VIA HAND DELIVERY**

Mr. William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: Ex Parte Presentation in MM Docket 92-266

Dear Mr. Caton:

Pursuant to 47 C.F.R. § 1.1206, United Broadcasting Corporation ("UBC"), through undersigned counsel, submits this original and one copy of a letter disclosing a written and oral ex parte presentation in the above-captioned proceeding.

On July 6, 1994, the undersigned and Matthew Ames met on behalf of UBC with Lisa Smith of Commissioner Barrett's office, Jill Luckett of Commissioner Chong's office, Merrill Spiegel of Chairman Hundt's office, Roz Allen of Commissioner Ness' office, and Maureen O'Connell of Commissioner Quello's office.

The meetings dealt with the maximum permissible rates for commercial leased access channels, including matters set forth in the attached written presentation of UBC. Copies of the attached written presentation were given to each of the FCC attendees at the meeting on July 6.

Very truly yours,

MILLER, CANFIELD, PADDOCK AND STONE

By

Tillman L. Lay

TLL:dmb
Enclosure
cc: Lisa Smith, Esquire
Jill Luckett, Esquire
Merrill Spiegel, Esquire
Roz Allen, Esquire
Maureen O'Connell, Esquire

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UNITED BROADCASTING CORPORATION

**DEVELOPING MAXIMUM PERMISSIBLE LEASED ACCESS CHANNEL RATES FOR ADVERTISER-SUPPORTED TIER LEASED ACCESS PROGRAMMERS: BASING THE RATE ON HISTORY AND MARKETPLACE EVIDENCE UNENCUMBERED BY THE EXTRA-MARKET INFLUENCE OF THE IMPLICIT FEE FORMULA**

1. Affordability to channel lessees must be the critical criterion in setting maximum permissible rates if leased access is to fulfill any of the objectives of Congress in amending 47 U.S.C. § 532.

   - Cable operators will treat the maximum permissible rate as the minimum rate.
   - Cable operators have no incentive to make leased access rates affordable; to the contrary, by making leased access rates unaffordable, operators can effectively relieve themselves of all leased access obligations. Thus, the FCC cannot rely on free market forces to induce operators to lower rates if there are no takers (or takers die out) at the maximum permissible rate.

2. The current implicit fee formula yields prohibitive, unaffordable rates for any advertiser-supported leased access programmer on the basic or expanded basic tier.

- The formula improperly allows operators to double recover subscriber revenues from advertiser-supported leased access programmers on the basic and expanded basic tiers.
- The longstanding industry practice for advertiser-supported tier programmers -- a practice established by operators and programmers themselves and which leased access providers had no role in creating -- is that net compensation runs <u>from</u> the cable operator <u>to</u> the programmer. The <u>only</u> exception is the case of must-carry broadcasters, which generally receive no compensation, but also pay no compensation to the cable operator. (While home shopping channels generally pay compensation to cable operators in the form of a percentage of sales, they are not advertiser-supported channels and thus should be treated as a separate class of leased access programmers. Determining the "going rate" for home shopping channels should be a simple task.)
- Some cable operators argue that leased access rates established in a manner similar to the FCC's current

formula are not prohibitive except for "poorly-financed" or "non-viable" programmers. This argument is flatly contradicted by marketplace evidence:

(a) If, as some operators argue, "adequately financed" and "viable" programmers could afford to pay leased access rates comparable to those yielded by the FCC's current rules, then the obvious question becomes: Why have cable operators, as rational profit-maximizers, not been charging those rates to the traditional (and presumably "viable"), non-leased access programmers on the operators' advertiser-supported tiers?

(b) In fact, the answer is obvious: No advertiser-supported tier programmer -- not even the "well-financed" and "viable" ones -- could afford to pay leased access rates as calculated by operators under the current implicit fee formula.

(c) The history of arrangements between operators and the established advertiser-supported programmers proves the point. The original advertiser-supported programmers in the late 1970s and early 1980s tried to survive solely on advertising revenues (although they, unlike leased access programmers, paid <u>no</u> compensation to operators for carriage). Even with free carriage, however, the traditional cable programming networks found it difficult to survive on advertising revenue alone. Indeed, the affiliate fees that operators pay to the established programmers today arose in the 1980s precisely because even the established programmers found that they could not survive on advertising revenues alone, but needed another revenue stream from operators.

(d) Rough calculations from public sources also prove the point. According to the 1994 Television & Cable Factbook, CNN (presumably a "well-financed" and "viable" programmer) had nearly 57 million subscribers and received 24-33 cents/month/ subscriber in affiliate fee revenues from cable operators. Using the FCC's implicit fee formula, cable operators in the Dade County, Florida, area have been demanding that leased access programmers pay rates of about 50 cents/month/subscriber. If CNN had to pay those rates (and, if, in the process of course, CNN lost its 24-33 cents/month/ subscriber in affiliate revenue), CNN would suffer a net loss from its present position of over $500 million, or half a billion dollars, per year.

(Over $300 million of this figure would represent what CNN would have to pay operators under the implicit fee formula; the rest would be lost affiliate fee revenues.) Even a well-financed programmer like CNN could not possibly survive a $500 million/year shortfall from its present position. In fact, according to published reports, CNN's total revenue for the first half of 1992 was only about $260 million. That is less than the $300 million CNN would have to pay to obtain carriage at the operators' new leased access rates.

3. While the issue of whether leased access is remunerative to the operator is certainly relevant, what is remunerative to the operator cannot be assessed in a vacuum; rather, it can only be assessed in the context of (1) what the operator itself has considered to be sufficiently remunerative in the context of other channels of a similar class; and (2) the operator's costs. When those factors are considered in the context of advertiser-supported tier channels, it is clear that any monetary compensation by leased access programmers to operators, no matter how small (say zero to 5 cents/subscriber/month) would make leased access channels

substantially <u>more</u> remunerative to the operator than any other advertiser-supported tier programmer.

- Since the operator pays an affiliate fee to every other advertiser-supported tier programmer, <u>any</u> net payment to the operator by a leased access programmer necessarily makes the operator's margin on the leased access channel <u>greater</u> than the margin it earns on any other non-leased access advertiser-supported channel on the tier.
- Moreover, in the case of an operator subject to rate regulation (on either the basic or expanded basic tier), the operator's maximum permitted rate is based on the number of channels on the tier. As a result, carrying a leased access channel entitles the operator to charge a higher subscriber rate, even though, unlike all other channels on the tier, the operator pays nothing to the programmer. If the operator is allowed to charge the leased access programmer as little as a penny or a nickel/subscriber/month for the channel, the leased access channel becomes a "win-win" situation for the operator: The operator is entitled to charge a higher rate to subscribers for carrying the channel while simultaneously earning revenue from the leased access programmer, a double revenue stream that no

other non-leased access advertiser-supported programmer provides to the operator.

- Cable operators have provided little in the way of data about the out-of-pocket costs they incur for leased access. What evidence there is suggests that the incremental cost must be negligible. The Center for Media Education and the Consumer Federation of America have submitted evidence to the Commission suggesting that the annual incremental costs to a cable operator for a full-time leased access channel is only $783.
- UBC's Dade County experience confirms that little or no compensation is necessary to make leased access channels remunerative for operators. Until operators began revising (and dramatically escalating) their leased access rates based on their interpretation of the FCC's implicit fee formula, UBC paid leased access rates ranging from zero (with advertising compensation that the operators never exercised) to $5000 per month. Given that these were rates voluntarily charged by operators in a pre-1992 Cable Act environment more hostile to leased access, these rates surely must have been remunerative and, given cable operators' market power, most likely excessively remunerative.

4. Operators' other arguments are nothing more than an attack on having any leased access at all.

- Some operators have complained that cable operators "will have to remove existing programming to accommodate channel lessees," thereby causing "subscriber disruption." This is really nothing more than an argument that operators should have no leased access obligations at all.
- Some operators have said that "reduced leased access rates" are unnecessary for "program diversity" because there are already "over 70 cable networks" and "a variety of highly diverse local programming ventures." This position reflects a fundamental misunderstanding of the diversity principle underlying leased access. Absent leased access, all programming carried on the system is filtered through a single gatekeeper: the cable operator. Regardless of the number or subjective variety of the programming a cable operator chooses to carry, there can be no true diversity as long as there is a single gatekeeper making all programming decisions.

<u>CONCLUSIONS</u>:

A. The FCC's current implicit fee formula makes no sense in the context of advertiser-supported tier leased access programmers. Indeed, none of the established, well-known cable programmers could possibly survive if, rather than receiving license fees from operators, they were charged leased access rates based on the implicit fee formula.

B. If leased access is to survive at all, the maximum permissible leased access rate for advertiser-supported tier leased access programmers must be negligible. UBC suggests that the maximum permissible rate should be in the range of zero to 5 cents per subscriber per month.